engaging in anticompetitive pricing.[70] Notably, most LECs agree that LRIC should be the basis for regulated monopoly interconnection rates, assuming private negotiation fails.[71]

In any event, the Commission should disregard the arguments in favor of rates that include a premium above LRIC.[72] There is no evidence that eliminating LEC monopoly pricing practices for their CMRS interconnection services will result in rate increases to other subscribers or undermine universal service.[73] Rather, policies that encourage competition, such as cost-based pricing for peer network interconnection, will result in lower prices for all end users and help achieve the Commission's universal service goals.[74] As AirTouch points out, raising interconnection rates above incremental costs would diminish the availability of interconnection to CMRS providers, reduce the incentives to invest in CMRS facilities, and, because the costs of interconnection must be passed on to consumers, decrease the use of CMRS.[75]

Ironically, when LECs are new entrants attempting to compete with incumbent carriers, they demand interconnection rates set at LRIC. BellSouth, for example, stated in a filing with the European Commission that "[i]nterconnection charges should largely reflect

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70/ Comments of MCI Telecommunications Corporation at 9.

71/ See Owen Reply Declaration ¶ 4.

72/ Comments of GTE at 33; Comments of Bell Atlantic, Statement of Robert W. Crandall at 4.

73/ See Owen Reply Declaration ¶ 7.

74/ Id. at ¶ 8.

75/ Comments of AirTouch Communications at 12.

long-run incremental costs (LRIC) caused by the interconnection."[76] Likewise, U S WEST strongly supported the United Kingdom's conclusion that "for the purpose of determining interconnection prices, the appropriate measure is long run average incremental cost."[77] Finally, Ameritech and Bell Atlantic argued in a filing with the Australian government that "[a]s a general principle, the pricing of interconnection should be set at a level which is not more than the direct incremental cost."[78]

B. Bill and Keep Would Appropriately Reflect the Costs LECs and CMRS Providers Incur in Terminating Each Other's Traffic

The absence of reliable incremental cost data is no basis for maintaining the status quo.[79] Because of their monopoly control of essential facilities, LECs are in a position to impose onerous and anticompetitive interconnection terms on their actual and potential CMRS competitors. Indeed, as demonstrated above, the LECs have consistently shirked their duty to engage in mutual compensation arrangements and have been charging wireless providers supra-competitive interconnection rates. The Commission is entirely correct that an interim policy is needed to balance interconnection arrangements until TSLRIC pricing is implemented.

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[76] See Comments of BellSouth Europe to the European Commission's Green Paper on the Liberalization of Telecommunications Infrastructure and Cable Television Networks at 4 (March 15, 1995).

[77] A Framework for Effective Competition, U S WEST International's Response to OFTEL's Consultative Document at 12 (March 30, 1995).

[78] Submission to AUSTEL on the Economic and Commercial Issues of Interconnection by Ameritech International and Bell Atlantic International at ¶ 1.1 (1991).

[79] Owen Reply Declaration ¶ 5.

The LECs' major complaint with the Commission's bill and keep proposal is that it would terminate a system under which CMRS companies subsidize the monopoly telephone industry. They argue that, because of traffic imbalances between the parties, bill and keep would not adequately compensate LECs.[80/] As a result, the LECs contend that they may be forced to raise rates to other users of the telephone network. They characterize bill and keep as "service without payment"[81/] that would subsidize the CMRS industry.[82/]

These LEC arguments point to the fact that the telephone companies have yet to acknowledge that they realize a significant value through interconnection with CMRS networks <u>for which they currently pay nothing</u>.[83/] As Owen points out, bill and keep would not require any significant rate increases to other users, particularly when it is understood that LECs save the expense they would otherwise have to expend for the cost of terminating their calls on CMRS facilities.[84/] The fact that the landline companies have failed to factor in those costs to date is entirely irrelevant.

Moreover, the LEC claim that bill and keep constitutes "service for free" is misleading for other reasons. While everyone agrees that traffic today between LEC and

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[80/] Comments of NYNEX at 28; Comments of SBC Communications Inc. at 11; Comments of Bell Atlantic at 7; Comments of U S WEST at 39.

[81/] Comments of BellSouth at 26.

[82/] <u>See</u> Comments of the National Telephone Cooperative Association at 8.

[83/] For example, the National Telephone Cooperative Association states that the bill and keep arrangements typically utilized between noncompeting LECs for extended area service ("EAS") arrangements are not appropriate for LEC-to-CMRS interconnection because EAS agreements occur when there is a benefit to both providers' customers. <u>Id.</u> at 18.

[84/] Owen Reply Declaration ¶ 7.

CMRS networks generally is imbalanced,[85] the LEC economists have failed to consider that overall costs might be roughly equal despite the imbalance.[86] As AT&T pointed out in its initial comments, the costs of terminating a call on a CMRS system are likely to exceed substantially the costs of terminating a call on a wireline system.[87] The LECs have provided no evidence to the contrary. In any case, the LEC concern about possibly subsidizing CMRS providers is indeed curious given that LECs have no qualms about demanding continued subsidies from the wireless industry.

[85] Compare Joint Comments of Sprint Spectrum and American Personal Communications at 21 with Comments of NYNEX at 28. (Sprint Spectrum notes that traffic originated on its new PCS system and terminated on the LEC network is essentially equal to the LEC-originated traffic it terminates, while NYNEX insists that the "nature" of CMRS service will prevent traffic from ever being balanced.).

[86] See Owen Reply Declaration ¶ 10.

[87] Comments of AT&T at 10-11.

CONCLUSION

For the foregoing reasons, the Commission should adopt a comprehensive bill and keep mechanism to govern LEC-to-CMRS interconnection until it is able to establish a long-term mutual compensation policy that requires the rates LECs charge for interconnection to be set at TSLRIC.

Respectfully submitted,

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March 25, 1996

F1/50555.3

Exhibit A

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Service Providers	CC Docket No. 95-185 CC Docket No. 94-54

Supplemental Declaration of Bruce M. Owen

1. I submitted a declaration in this proceeding previously. My qualifications are listed there.

2. I have been asked by counsel for AT&T Wireless Services, Inc. to analyze the arguments made by economists retained by various local exchange carriers ("LECs") in this proceeding.[1] None of the arguments presented by these economists ("LEC economists") changes my earlier conclusions. Briefly, those conclusions are: (1) Current interconnection arrangements between commercial mobile radio service (CMRS) providers and LECs are skewed in favor of LECs. On account of market power, LECs are in a position to impose onerous and anti-competitive interconnection terms on their actual and potential "peer network" competitors. (2) The Commission is correct that an interim policy is needed to balance interconnection arrangements until cost-based interconnection terms can be determined. (3)

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1 In particular, I have analyzed the following submissions by economists ("LEC economists") in the latest round of pleadings in this proceeding: the statement filed by Professor Jerry A. Hausman, sponsored by Pacific Telesis; the affidavit by William E. Taylor, sponsored by NYNEX; the response by Professor Robert G. Harris, sponsored by US West; the statement by Robert W. Crandall, sponsored by Bell Atlantic; and the report by Strategic Policy Research, sponsored by the United States Telephone Association.

Until the long-run incremental costs for terminating CMRS calls on LEC facilities can be accurately determined, a "Sender Keep All" or "Bill and Keep" (BAK) arrangement is pro-competitive and economically appropriate. In particular, I pointed out in my earlier submission that BAK would be a reasonable interim solution to the problem of interconnection rates because, while traffic is imbalanced in one direction, unit costs are probably imbalanced in the offsetting direction.

3. The LEC economists seem to view the BAK proposal with something approaching outrage. Their chief complaint seems to be that BAK would terminate a system under which competitive CMRS companies subsidize monopoly wireline companies. Their position reflects a long-discredited approach to public policy in telecommunications.

4. In spite of the rhetoric, there is a substantial area of agreement among the economic commentators as to the *long run* solution to the problem of pricing interconnection services offered by monopoly LECs. All agree that long run incremental cost (LRIC) should be the "basis" for regulated monopoly interconnection rates, assuming private negotiation fails. (See Crandall at 4, Harris at 4, Hausman at ¶ 11.) But as I previously noted, the long-run incremental costs for LECs to terminate CMRS-originated traffic have yet to be determined. At least one of the LEC economists apparently agrees. (See Crandall at 5.)

5. The absence of reliable incremental cost data is no basis to accept the status quo. The Commission cannot ignore the current serious problem of monopoly LEC overcharges for interconnection, especially when the overcharges are by the LECs systems to their actual and potential CMRS *competitors*. I strongly disagree with Professor Hausman's policy recommendation that the Commission should continue its current policy of relying on individual parties to arrive at mutually agreeable interconnection terms. (Hausman at ¶ 48.) Professor Hausman agrees that problems are created in such circumstances when market power is involved, but, astonishingly, dismisses this concern because CMRS providers do not have market power!

(Id.) I agree that CMRS providers do not have market power, but LECs clearly do. LECs have exercised this market power in imposing interconnection prices that are above costs. Strategic Policy Research (at 1) reports that current charges to CMRS providers for interconnection exceed costs by more than two to one. Indeed, all of the concern expressed by the LEC economists that BAK would result in lost "contribution" to LEC services is an implicit recognition that LECs are currently pricing interconnection to CMRS providers above costs. The fact that LECs typically do not compensate CMRS providers at all for terminating LEC-originated calls only compounds this monopoly pricing problem. Dr. Taylor acknowledges that BAK would solve the problem of monopoly overcharges but would not prevent LECs from degrading service quality or engaging in non-price discrimination. (Taylor at ¶ 9.) I agree that those are additional potential problems, but they only point to the necessity for the Commission to adopt pro-competitive policies such as BAK that will speed the day when LECs no longer can exercise market power. This point is central. CMRS carriers compete today with LEC-owned wireless services, and they may someday compete with wireline services, but only if LECs are prevented from raising CMRS costs to the point where they cannot compete.

6. Some LEC economic commentators take the offensive with respect to these monopoly overcharges, and assert that CMRS companies should pay a premium over LRIC, *i.e.*, monopoly prices, in order (1) to avoid the need for rate increases to other subscribers, (2) to maintain a subsidy to support universal service, and (3) to contribute to fixed and common overhead costs arising from economies of scope. None of these reasons withstands scrutiny. Indeed, it is ironic that LEC economists seem universally opposed to bill and keep based on their concern that LECs might subsidize CMRS providers, yet they have no qualms seeking subsidies to the monopoly LECs.

7. The need to avoid rate changes for other users of LEC facilities is hardly a sound economic justification for pursuing an anticompetitive pricing pol-

icy. Too often in the past inefficient and inappropriate pricing decisions have been made by regulators seeking to avoid disturbances in the status quo. If economically sensible pricing requires other users to pay more, no economist, at least, should be advocating a different course. Moreover, as I pointed out previously, interconnection benefits wireline subscribers and increases the value of their service. Finally, it is difficult to imagine that any significant rate increases would be required by a BAK approach, particularly when it is remembered that the LECs save the expense they would otherwise have to make for the cost of terminating their calls on CMRS facilities.

8. The maintenance of subsidies to LECs in an artificial effort to reduce prices charged to allegedly high-cost LEC subscribers will merely ensure that inappropriate high-cost technology is *always* used to serve such customers. Wireless technology offers the potential to provide telephone service to many such subscribers at lower cost than wireline technology. LEC economists' recommendations to tax wireless providers to subsidize high-cost wireline provision will ensure that we never move to a more efficient provision of telephone services. Indeed, such a policy attempts to maintain universal service at higher social costs than are otherwise necessary. Lower prices for all subscribers as well as universal service goals are best met by a policy that encourages competition. Competition will ensure that costs are minimized and that only efficient suppliers survive. If LECs have adopted high-cost, inefficient technology, the answer is not to enshrine those mistakes, but rather to replace that technology with lower-cost, more efficient technology. Policies that encourage competition are the best means to achieve these goals.

9. Similarly, claims that competitors should contribute to LEC overhead costs which are not covered by LRIC-based prices due to economies of scope or scale are without merit. There has been no showing such economies of scope are significant or that LECs' decisions to adopt technologies with substantial common costs minimize the social costs of producing tele-

phone services. Indeed, absent the stimulus of competition, the presumption is that LECs have not minimized costs. Imposing taxes on competitors to support these inflated and unnecessary costs once again flies in the face of policies designed to minimize costs and therefore prices to telephone subscribers.

10. As to the *interim* solution to the interconnection problem, everyone agrees that there is a traffic imbalance between LECs and CMRS providers. Further, everyone agrees that BAK makes sense as an interim approach only if overall costs are roughly equal on the two sides. But none of the LEC commentators seems to have considered the possibility that the overall costs are likely to be roughly equal despite the traffic imbalance because the *unit* costs differ sharply. In my earlier declaration I presented some reasons why the cost of terminating a call on a CMRS system might substantially exceed the cost of terminating a call on a wireline system. Nothing in the LEC submissions provides evidence to the contrary. In particular Professor Harris' observation that LECs serve the highest cost landline customers (see Harris response at 4) has nothing to do with whether LECs' *incremental* costs of terminating calls to those customers are higher than CMRS providers' incremental termination costs. Although LECs' fixed local loop costs to serve some subscribers may well be high, this is due in part to misguided policies that have allowed them to string wire to all subscribers irrespective of density, distance and other cost considerations, instead of using wireless technology. In spite of this, LECs' incremental costs of delivering calls to such subscribers are likely to be very low.

11. The major objections on efficiency grounds of the LEC economists to BAK as an interim solution are that prices do not correspond to costs, and that inefficient wireless technology will be subsidized with this policy. As pointed out in my earlier submission, LEC incremental termination costs per call are low, so that no serious allocation distortion would likely occur under an interim BAK policy. In addition, LECs are likely to be adequately compensated in total under a BAK policy due to higher incremental termi-

nation costs per call for CMRS providers that LECs will not have to pay under a BAK policy. It is unlikely, therefore, that BAK will result in a net subsidy to CMRS providers. Indeed, its main pro-competitive effect will be the elimination of the existing subsidy to LECs flowing from monopoly interconnection charges.

I declare under penalty of perjury that the foregoing is true and correct.

Bruce M. Owen

March 25, 1996

CERTIFICATE OF SERVICE

I, Tanya Butler, hereby certify that on this 25th day of March, 1996, I caused a copy of the foregoing Reply Comments of AT&T Corp. to be sent by first class mail, postage prepaid, or to be delivered by messenger (*) to the following:

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